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ANALYZING THE SERIOUS ISSUE OF NPA's IN THE BANKING SYSTEM WITH A CRITICAL STUDY OF DHFL SCAM IN INDIA- Maitreyi Agrawal¹**ABSTRACT**

The emergence of a new financial scam of more than 34,000 crores as pronounced by the CBI had shocked the entire nation all over again. This awful happening of the biggest fraud in the money market had directly or indirectly affected India's economy along with having a vicious attack on investors' trust. Banking fraud not only affects the image of the country worldwide but drastically disturbs the banking system, governance policies, investors' money, and society at large. The DHFL scam is an outcome of bad governance practices in the NBFC and a lack of supervision by the higher authorities. It boosted the bad loans and non-performing assets of the consortium of the banking sector. In this research paper, the researcher has provided a brief overview of non-banking financial companies followed by a comprehensive study of the DHFL scam and how it was pulled off together with its impact on banks. This paper emphasized the political contributions and the loopholes in the system that assists the execution of the scam in conjunction with the conclusion and suggestions to forestall such failures.

Keywords: Banking System, Corporate Governance, DHFL Scam, NBFC, Non-Performing Assets

RESEARCH OBJECTIVE

To make a comprehensive study of the DHFL scam of India and analyze the issue of NPAs in banking system caused by the scam followed by the suggestive measures in order to prevent such scams.

INTRODUCTION

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Understanding of NBFCs

India's financial market is filled with a variety of banks including commercial banks, cooperative banks, regional rural banks (RRBs), etc. they have a large number of branches at different cities with a strong balance sheet and asset size. Therefore, individuals are encouraged to invest in the banking sector with minimal risk factors. Commercial banks, however, avoid to lend money in the unorganized or rural, or semi-urban sector of society because of the inclusion of high costs, high risk of default, and inadequacy of networks. This results in a gap in credit or loan facilities in the unorganized sector as compared to the organized sector of society. In order to build the occurred gap, the government came up with an innovative institution which is named "Non-Banking Financial Institution". NBFI is a broader term for the NBFC.²

NBFCs are governed and regulated by the RBI Act, of 1934 which prescribes its meaning, functioning, limitations, etc. in a codified form. According to section 45I, it refers to "a company that receives deposits under any scheme/ arrangement or otherwise as its principal business for the purpose of lending in any manner". The term "principal business" is not attempted to define by RBI but it has come up with a test called 50-50 in order to ascertain whether a company is involved in a financial activity or not.

NBFCs have a significant role to play in the financial market which is complementary and in addition to the functioning of the banking sector in terms of achieving effectiveness and diversity in the market. They promote the growth of areas where banks have a limited access. These institutions are crucial for the development and betterment of Indian economy by providing services to the rural areas where banks cannot reach. They generally provide loans at the semi-urban fields at a comparatively lesser interest rate and thus, enable the advancement of the backward spaces.³ The institutions arose during 1980s simplified the loan

² Pratik Datta, Varun Marwah & Ulka Bhattacharyya, Resolving Financial Firms in India: The Way Forward, 13 NUJS L. REV. 1 (2020).

³ Cristian Dima & Radita Corches, Non-Bank Financial Institutions. Types and Functions, 5 CONTEMP. Readings L. & Soc. Just. 700 (2013).

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sanctioning operations and abridged the gap between rural and urban area by meeting the exigencies of variety of customers.

Banks v NBFCs

Banks and NBFCs seem to be similar; however, they differ in a variety of ways. For instance, the Banking Regulation Act of 1949 came into place when we talk about the incorporation of banks or the commencement of banking business. The NBFCs, however, are incorporated under the Companies Act of 2013 along with the details prescribed under the RBI Act, of 1934. Further, demand deposits are allowed in the case of banking business; however, NBFCs disallow demand deposits from the public at large. Plus, banks are known for credit creation; however, this is not the case in the non-banking business. Also, provisions of a variety of reserves are mandatory in banks, however, not for NBFCs. Lastly, payment & settlement systems including the RTGS, credit cards, etc. are the basic services of banking sectors, but not of the NBFCs.

DHFL- A Good Start

Good governance is a prerequisite for the success of an organization. It not only encourages business growth but is beneficial for the country's economy as well.⁴ However, the factors like corruption, malpractices, dishonesty and fraudulent practices in the management system led to the inclusion of new fraud in the news reports.⁵ Recently, the Central Bureau of Investigation declared the 3rd biggest banking fraud in India which involves the amount of Rs. 34,615 crores.⁶ The scam was carried out by Kapil Wadhawan along with Dheeraj Wadhawan in the Dewan Housing Finance Ltd, a non- banking finance corporation. DHFL scam can be called "systematic stealing" of public money done at the back of public authorities and in daylight.

DHFL was registered as an NBFC with the role of providing house loans to middle-income groups living in rural and semi-urban areas at a comparatively lesser interest rate. It has its

⁴ Simone M. Sepe, *Regulating Risk and Governance in Banks: A Contractarian Perspective*, 62 EMORY L.J. 327, 401 (2012).

⁵ Hwa-Jin Kim, *Financial Regulation and Supervision in Corporate Governance of Banks*, 41 J. CORP. L. 707, 709 (2016).

⁶ CBI books DHFL in 'biggest' banking fraud of Rs 34,615 crore; 17 banks hit, BUSINESS STANDARD (June 23, 2022 01:52 IST), https://www.business-standard.com/article/companies/cbi-books-dhfl-former-cmd-and-director-in-rs-34-615-crore-bank-fraud-case-122062200611_1.html.

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headquarters in the city of Mumbai. It was incorporated by Rajesh Kumar Wadhwan in the year of 1984 and earned a good reputation in the market with high profitability and stability in the market. However, that cannot be maintained in the future time and consequently, turned into the biggest financial scam of India.

Course to DHFL Scam: The Biggest Banking Fraud till Date

The whole story of stealing Rs. 34, 615 crores of Indian Banks and retail investors is put forth in order to ascertain the facts distinctly.

PRESS RELEASE OF AN INVESTIGATIVE COMPANY NAMED COBRAPOST

The Cobrapost came up with a piece of news on 29 January 2019 disclosing the biggest financial scam of India where promoters of DHFL extract more than Rs. 31,000 crores by establishing shell companies, providing political contributions, exercising insider trading, money laundering, etc. Loans were disbursed without any collateral securities to the shell companies and without practicing any due diligence process which made the re-back of loans completely impossible. In addition to this, for converting the black money into white, the promoters of DHFL purchased shares and other assets not only in India but also in Dubai, Mauritius, the United Kingdom, and Sri Lanka. By scrutinizing the official records, the investigating agency proclaimed that illegal political contributions were made by companies named “RKW Developers Private Limited”, “Darshan Developers Private Limited” and “Skill Realtors Private Limited” which are directly related to the Wadhawans group. This envisaged the BJP's assistance in the happening of such an awful scam.⁷ Such political contributions or donations are prohibited under section 182 of the Companies Act, 2013.

However, all the allegations were refused by Kapil Wadhwan and Deeraj Wadhawan and they made a statement that the claims of Cobrapost are malafide in nature.

DOWNGRADING OF DHFL

Though the directors denied the report of Colrapost, but truth cannot remain in dark for a longer period. From June 2019 onwards, DHFL started delaying the payment of interest rate

⁷ Press release: Anatomy of India's Biggest Financial Scam Pulled Off by Dewan Housing Finance Corporation, COBRAPOST, (Jan. 29, 2019), <https://cobrapost.com/blog/press-realise-dhfl-l/1374>.

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on the loans which leads to the downgrading of the share pricing of DHFL. Consequently, its shareholders' wealth was wiped off by 97 % which ultimately minimized its goodwill.

In October of the same year, ED i.e., Enforcement Directorate conducted raids in the office of DHFL along with the residence area of promoters and directors in connection with the money laundering activities carried out by them.

RESERVE BANK OF INDIA IN THE PICTURE

Afterward, seeing the malpractices carried out in DHFL, RBI as a Central Bank and as a supervisor of NBFCs⁸ came into the picture on November 20, 2019. DHFL as a defaulter of Rs.83,873 crores referred by RBI to NCLT to initiate insolvency proceedings against the company under section 227 of the Insolvency & Bankruptcy Code of India. Additionally, most of the directors of DHFL were removed from the board by RBI.

MISUSE OF PRADHAN MANTRI AAWAS YOJANA SCHEME BY DHFL

There was a scheme named Pradhan Mantri Aawas Yojana Scheme released by the Modi's Government in the month of October, 2015 in order to provide housing loans to people efficiently. DHFL was granted loans under the same scheme in the year 2021. Central Bureau of Investigation filed a suit against DHFL's promoters for creating 2,60,000 fake loan accounts under the PMAY scheme. The report of Grant Thornton revealed that from PMAY, they were granted 14,046 crores, out of which 11,755 crores were sent out to shell companies and a Bandra Branch was constituted only on the papers to make a false database of loan accounts.⁹ The forensic report claimed that the money laundering practices are at their peak.¹⁰

APPROVAL OF RESOLUTION PLAN UNDER IBC

⁸ Pratik Datta, Varun Marwah & Ulka Bhattacharyya, *Resolving Financial Firms in India: The Way Forward*, 13 NUJS L. REV. 1, 8 (2020).

⁹ Aditi Shobha & Diksha Kumari, *DHFL Scam and the Entire Rigmarole*, 4 INT'L J.L. MGMT. & HUMAN. 6065, 6068 (2021).

¹⁰ *DHFL booked for creating 2.60 lakh fake home loan accounts under PMAY*, THE HINDU, (Mar. 24, 2021, 21:20 IST), <https://www.thehindu.com/news/national/dhfl-booked-for-creating-260-lakh-fake-home-loan-accounts-under-pmay/article34153356.ece>.

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In the month of January of 2021, Piramal Capital & Housing Finance enterprises merged with DHFL by paying an amount of Rs. 34,250 crores to the DHFL's creditors.¹¹ Finally, DHFL came out of the process of winding up.

DECLARATION OF THE BIGGEST FRAUD EVER

On 22 June 2022, CBI booked saying that DHFL has done the biggest fraud ever in our country of amount 34, 615 crores and filed a suit against Dheeraj Wadhawan, Kapil Wadhwan, and 13 other accused persons who have defrauded 17 banks in total in which Union Bank of India was leading them.¹²

Firstly, it was the Neerav Modi scam of 13,000 crores and then ABJ shipyard, which is a scam of 20,000 crores. And now DHFL scam of more than 34,000 crores lies on the top in the financial market.

DHFL, A CASE OF POOR GOVERNANCE

No proper accounting system, no disclosures, formation of shell companies, and money laundering are all signs of failure of corporate governance. Following the norms of corporate governance is a tool for high profitability and long-term stability in the market.¹³ However, in Deewan Housing Finance Limited, most of the things were on paper with zero execution. There was a less internal control system with no role of independent directors and audit committee and thereby, it failed to comply with the business ethics. The company made illegal political donations, committed fraud, not adhered to the formation of the audit committee, breached the limit of investment, involved in related-party transactions, therefore, accountable under Sections 182, 447, 177, 186, and 185 of the Companies Act, 2013 respectively.¹⁴

¹¹*Piramal Capital & Housing Finance acquires DHFL via reverse merger*, BUSINESS STANDARD (October 1, 2021 11:43 IST), https://www.business-standard.com/article/companies/piramal-capital-housing-finance-acquires-dhfl-via-reverse-merger-121100100379_1.html#:~:text=Piramal%20Enterprises%20on%20Friday%20said,the%20troubled%20housing%20finance%20company.

¹²*DHFL scam: The family accused of the biggest banking fraud knows how to stay out of jail*, THE ECONOMIC TIMES (Jun 27, 2022, 11:54 AM), <https://economictimes.indiatimes.com/industry/banking/finance/banking/dhfl-scam-the-family-accused-of-the-biggest-banking-fraud-knows-how-to-stay-out-of-jail/articleshow/92467586.cms>.

¹³ Simone M. Sepe, *Regulating Risk and Governance in Banks: A Contractarian Perspective*, 62 EMORY L.J. 327, 402 (2012).

¹⁴ Aditi Shobha & Diksha Kumari, *DHFL Scam and the Entire Rigmarole*, 4 INT'L J.L. MGMT. & HUMAN. 6065, 6067 (2021).

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IMPACT ON BANKING SECTOR

DHFL had defrauded 17 banks in total as per the complaint of Union Bank of India. It is a scam of the amount of 34,615 crores committed by Dheeraj Wadhawan, Kapil Wadhwan, and 13 other accused persons. Under the PMAY scheme, they were granted 14,046 crores and out of which 11,755 crores were transferred to shell companies by constituting the Bandra Branch.¹⁵ The loans which were granted by DHFL were not attached to the collateral securities and indirectly, came into the pocket of Dheeraj and Kapil Wadhwan. The whole amount, either the loan or the interest is unrecoverable. These illegal practices cast a drastic impact on the banking sector by creating a large amount of “Non-Performing Assets”. These NPAs affects the profit margin of banks and give rise to liquidity issues in the economy as a whole.

Analysis of the whole Scenario

The following analysis can be drawn from the entire scenario

1 By looking at the whole process of execution of such a dire scam in India, it is much understandable that there is an absence of effective governance inside the company. The directors of the company were involved in insider trading, money laundering, manipulation of financial statements, creation of fake loan accounts and much more. There was weak auditing system inside the company and no disclosures relating to the lenders of DHFL.

2 The scam of DHFL is the most recent banking fraud in India which depicts that the banking system is still not free from the issue of NPAs i.e., Non-Performing Assets. The loans granted under the PMAY scheme and other schemes for the benefit of common people to encourage and help them in constructing houses by providing loans at a reasonable interest rate were not reached to them in the real sense. As per the report of Grant Thornton, DHFL was granted 14,046 crores, out of which 11,755 crores was sent out to shell companies through the Bandra

¹⁵ Aditi Shobha & Diksha Kumari, *DHFL Scam and the Entire Rigmarole*, 4 INT'L J.L. MGMT. & HUMAN. 6065, 6068 (2021).

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Branch.¹⁶ No actual benefit took place for the public at large by such schemes and simultaneously, it created the problem of NPAs as the amount is unrecoverable now.

3 Moreover, it should be taken into consideration that, India is going to face such awful banking fraud was not known till the Cobrapost came up with its news by scrutinizing the official and other records available to them. That is to say, the government agencies were not able to find out what the news reporters did. Further, no action or enquiry was initiated against the directors of DHFL after the allegations made by the agency.

In addition to this, the Corbrapost alleged that illegal political contributions were made by companies named “RKW Developers Private Limited”, “Darshan Developers Private Limited” and “Skill Realtors Private Limited” which are directly related to the Wadhawans group.¹⁷ This envisaged that the loans to Wadhawans were going to Central Government in the form of donations; so that the BJP's assistance could be seek to execute the scam.¹⁸ Moreover, the former Shiv Sena MLA Dalvi is a shareholder of the Sahana Group which was affiliated with the shell companies formed by the directors of DHFL.

CONCLUSION & SUGGESTIONS

DHFL was a Non-banking Finance Company which was constituted to provide housing loans to the lower or middle class of society where the banks have lesser reach. The working pattern of DHFL was quite systematic and lawful for the initial years. Anyhow, time changed the intentions and malafide interest of the directors named Dheeraj and Kapil Wadhawan whipped off 34, 615 crores of the common people. Not just the common people lost their hard earned money in this scam but Rakesh Jhunjhunwala, pronounced businessman had also lost crores of rupees in this biggest bank fraud. Such scams demonstrate the failure of legal system and create an urge to prevent such failures. Some suggestions are pointed out by the researcher to avoid such failures-

¹⁶ Aditi Shobha & Diksha Kumari, *DHFL Scam and the Entire Rigmarole*, 4 INT'L J.L. MGMT. & HUMAN. 6065, 6068 (2021).

¹⁷ Aditi Shobha & Diksha Kumari, *DHFL Scam and the Entire Rigmarole*, 4 INT'L J.L. MGMT.& HUMAN. 6065, 6072 (2021).

¹⁸ Press Release: ANATOMY OF INDIA'S BIGGEST FINANCIAL SCAM PULLED OFF BY DEWAN HOUSING FINANCE CORPORATION, COBRAPOST, (Jan. 29, 2019), <https://cobrapost.com/blog/press-realise-dhfl-1/1374>.

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1. There should be proper check by the banks while providing loans to NBFCs that how it is being utilized by them with adequate inspection from time to time.
2. NBFCs should be made responsible to provide a monthly report to the concerned banks from where the loans are granted to them, showing the ledger of utilization of the funds.
3. There is a need on the part of the government to check and make an assessment of the financial risks involved in the NBFCs on a regular basis.
4. There should be an appointment of experts as well as an independent committee that can scrutinize the functioning of NBFCs on a regular basis.
5. There should be a legitimate inspection carried out by RBI as a supervisor of NBFCs, when and where any irregularity seemed to be in existence.

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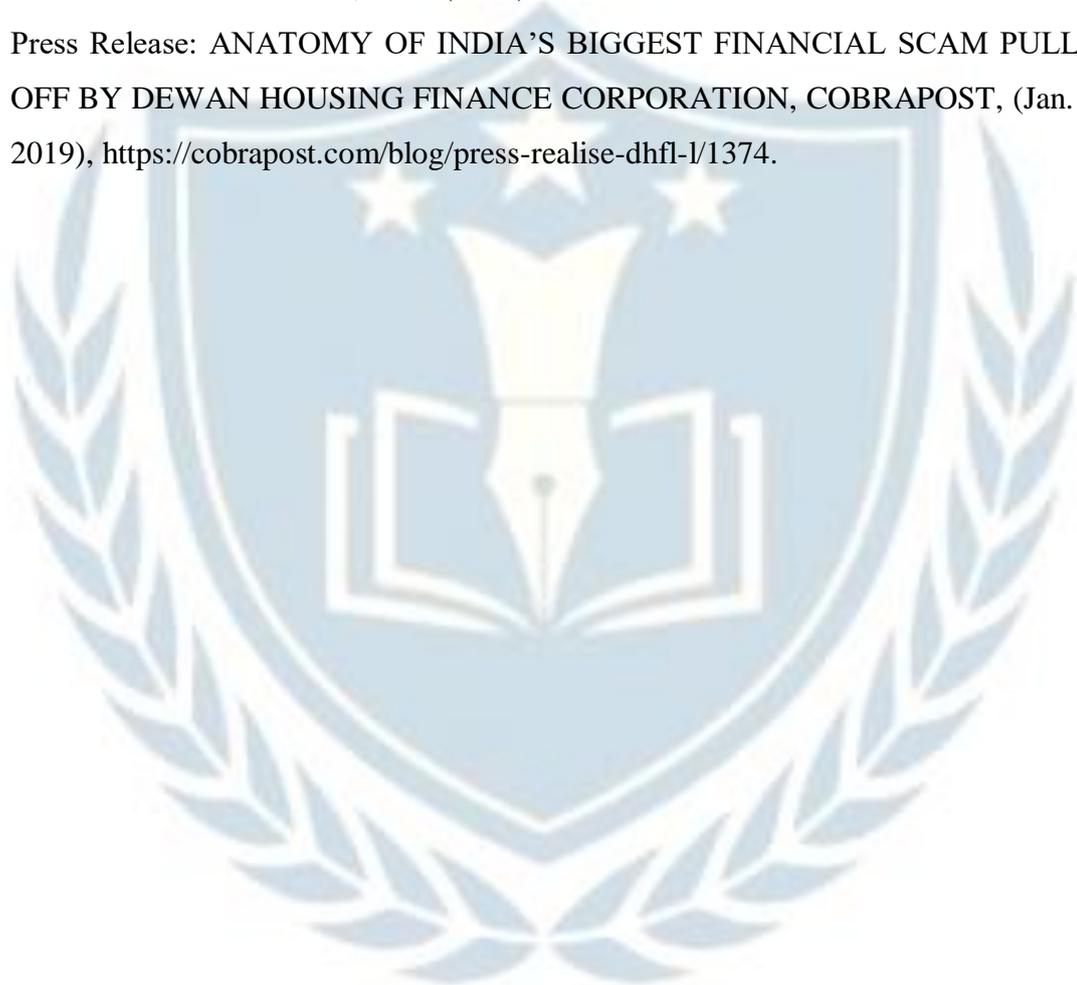
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